

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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|----------------------------------|---|-----------------|
| BURKESVILLE GAS COMPANY, INC., |) | |
| KEN-GAS OF KENTUCKY, INC., AND |) | |
| KEN TURNER |) | |
| _____ |) | CASE NO. 92-178 |
| |) | |
| ALLEGED VIOLATION OF KRS 278.300 |) | |

O R D E R

The Commission initiated this proceeding to determine whether Burkesville Gas Company, Inc. ("Burkesville Gas"), Ken-Gas of Kentucky, Inc. ("Ken-Gas"), and Ken Turner had executed a capital lease agreement which resulted in Burkesville Gas assuming a long-term debt without prior Commission approval in violation of KRS 278.300.

Burkesville Gas is a Kentucky corporation formed in 1990 as a local distribution company. The president of Burkesville Gas is Ken Turner. Mr. Turner holds 49 percent of the stock in Burkesville Gas; Consolidated Financial Resources, a Texas corporation of public financiers, holds 51 percent. Burkesville Gas, by virtue of the lease agreement, is now the entity responsible for the day-to-day operation of the gas system used to supply the residents in and around Burkesville, Kentucky.

Ken-Gas is a Kentucky corporation organized in 1985 which provided natural gas distribution services to customers in the Burkesville, Kentucky area until January 25, 1992, the effective date of the capital lease agreement. Ken Turner is the president

of Ken-Gas. In 1990, Ken-Gas entered into an agreement to sell the distribution system assets to the newly formed Burkesville Gas for \$840,200. The Commission approved the sale of the system and the issuance of \$1,300,000 in bonds in Case No. 90-294.¹ Burkesville Gas was unable to issue the bonds necessary to finance the purchase of the distribution system and Ken-Gas continued to own the assets and operate the gas distribution system serving Burkesville, Kentucky until January 25, 1992 when the capital lease was entered into with Burkesville Gas.

The Uniform System of Accounts ("USoA") prescribed for gas utilities operating in Kentucky requires that an asset and related liability be recorded on the balance sheet of the lessee if the lease qualifies as a capital lease. Burkesville Gas reported that the present value of the minimum lease payments required by the lease with Ken-Gas is equal to \$873,127. This represents 90 percent or more of the value of the assets and, therefore, qualifies as a capital lease under the terms set out in the USoA. Burkesville Gas should account for the capital lease in accordance with the USoA with the leased assets being recorded in Account 101.1, Property under Capital Lease, and the obligation in Account 227, Obligation under Capital Leases, at an amount equal to the present value, at the beginning of the lease term, of the minimum

¹ Case No. 90-294, The Application of Burkesville Gas Company, Inc. for Approval of the Transfer and Sale of Ken-Gas of Kentucky, Inc. and Application of Burkesville Gas Company, Inc. for an Order Authorizing the Creation and Issuance of \$1,300,000.00 of Long Term Instruments of Indebtedness.

lease payments during the lease term. However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the asset and obligation shall be the fair value.

The capital lease agreement contains a purchase option for the sum of \$840,358.08. This is approximately the same amount as approved in Case No. 90-294. Since the purchase option of \$840,358 is less than the present value of the minimum lease payments (\$873,127) this is the amount that Burkesville Gas should record in Accounts 101.1 and 227. Records should be maintained with respect to the capital lease reflecting: (a) name of lessor; (b) basic details of the lease; (c) terminal date; (d) original cost of the property leased; (e) future minimum lease payments; (f) executory costs; (g) present value of the minimum lease payments; (h) the amounts representing interest and the interest rate used; and (i) expenses paid.

KRS 278.300 states that "no utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability. . .until it has been authorized to do so by order of the Commission." No evidence was presented at the hearing held on June 16, 1992 by any of the parties to this proceeding to dispute that the lease agreement between Burkesville Gas and Ken-Gas should properly be considered a capital lease. Burkesville Gas did not seek Commission approval prior to entering into this capital lease and assuming the associated long-term debt. KRS 278.990(4) states that,

Any utility that issues any securities or evidences of indebtedness, or assumes any obligation or liability in respect to the securities or evidences of indebtedness of any other person, or makes any sale or other disposition of securities or evidences of indebtedness, or the proceeds thereof, for purposes other than the purposes specified in the order of the commission made with respect thereto under KRS 278.300, shall be fined not more than ten thousand dollars (\$10,000).

Burkesville Gas' evidence at the June 16, 1992 hearing reveals that the company entered into the capital lease agreement as a stop-gap measure until it is able to market the bond issue approved by this Commission in Case No. 90-294.

The lease agreement entered into on January 25, 1992 enabled Burkesville Gas to gain control of the gas system, obtain a short-term construction loan from the Bank of Clinton County and begin making extensions to add additional customers to the system. Burkesville Gas indicated at the hearing that these steps were necessary in order to establish a track record for operating the system which should improve the marketability of the bond issue so that the transfer and financing approved in Case No. 90-294 could be consummated. Burkesville Gas further indicated that it was the company's intention to effect the bond sale and transfer within one year of the time Burkesville Gas began operating the system under the capital lease on January 25, 1992.

The purchase option price specified in the lease agreement is substantially the same as the purchase price in the sales agreement approved in Case No. 90-294. Furthermore, the lease agreement specifies that the sale and transfer will take place if and when the bonds approved in Case No. 90-294 are sold. In the interim,

all lease payments will apply toward the purchase price of the assets. If the bonds are not sold and the capital lease remains in effect, Burkesville Gas will purchase the system prior to the end of the 191 month lease term and will be the owner of the system at that time. After review of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Burkesville Gas is now and has been since January 25, 1992 the operator of the distribution system used to serve the customers in and around Burkesville, Kentucky.

2. Burkesville Gas did incur an obligation for which prior Commission approval is required pursuant to KRS 278.300. Burkesville Gas did not obtain prior Commission approval of the capital lease agreement.

3. Burkesville Gas should be assessed a penalty of \$100 for its violation of KRS 278.300.

4. The capital lease agreement that resulted in the assumption by Burkesville Gas of a long-term liability is, based upon the representations of the parties, for a lawful object within its corporate purposes, is necessary for the proper performance by the utility to perform its distribution service, and is reasonably necessary and appropriate for such purpose.

IT IS THEREFORE ORDERED that:

1. A penalty in the amount of \$100 is assessed against Burkesville Gas for its failure to comply with KRS 278.300. The penalty assessed herein against Burkesville Gas shall be due within 30 days of the date of this Order. Payment shall be made by

certified check or money order made payable to Treasurer, Commonwealth of Kentucky. Said check or money order shall be mailed or delivered to the Office of General Counsel, Public Service Commission, 730 Schenkel Lane, P. O. Box 615, Frankfort, Kentucky 40602.

2. The capital lease agreement made between Burkesville Gas and Ken-Gas be and it hereby is approved.

3. Burkesville Gas shall, within 30 days of the date of this Order, file an executed adoption notice adopting the current rates of Ken-Gas.

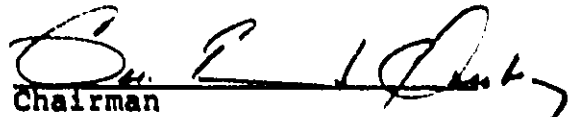
4. Burkesville Gas shall maintain its records in accordance with the USoA.

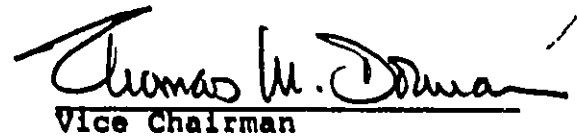
5. Burkesville Gas shall within 15 days of the date of this Order file journal entries reflecting the recording of the capital lease on its books at January 25, 1992 and shall file its balance sheet at January 25, 1992 reflecting the capital lease and any other transactions that should properly be reflected on the balance sheet.

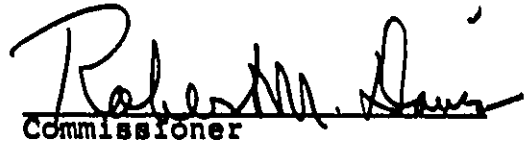
6. Burkesville Gas shall file notice with this Commission no later than 60 days prior to the sale of the bonds approved in Case No. 90-294 of its intention of selling said bonds. The terms and conditions of said issuance shall in all respects be the same as those approved by the Commission in Case No. 90-294.

Done at Frankfort, Kentucky, this 28th day of October, 1992.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director